No. 276.

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1923.

WILLIAM H. EDWARDS, FORMERLY COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK,
Petitioner,

v.

JOSEPH JERMAIN SLOCUM, HERBERT JERMAIN SLOCUM, STEPHEN L'HOMMEDIEU SLOCUM, ROBERT W. DE FOREST AND HENRY W. DE FOREST, AS EXECUTORS OF THE LAST WILL AND TESTAMENT OF MARGARET OLIVIA SAGE, DECEASED,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND DISTRICT.

BRIEF FOR THE RESPONDENTS.

DE FOREST BROTHERS,
Attorneys for Respondents.

ROBERT THORNE,
Of Counsel.

The Evening Post Job Printing Office, Inc., 154 Fulton St., New York, N. Y.

INDEX.

TABLE OF CASES.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1923.

WILLIAM H. EDWARDS, formerly Collector of Internal Revenue for the Second District of New York,
Petitioner,

v.

JOSEPH JERMAIN SLOCUM, HERBERT JERMAIN SLOCUM, STEPHEN L'HOMMEDIEU SLOCUM, ROBERT W. DE FOREST and HENRY W. DE FOREST, as Executors of the Last Will and Testament of Margaret Olivia Sage, deceased,
Respondents.

No. 276.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENTS.

By this writ of certiorari the petitioner, formerly the Collector of Internal Revenue for the Second District of New York, seeks review of a judgment of the Circuit

Court of Appeals for the Second Circuit affirming a judgment of the District Court for the Southern District of New York in favor of the respondents and against the Collector for $412,366.42, with interest, for the balance of an additional estate tax, held to have been improperly and unlawfully assessed upon the estate of Margaret Olivia Sage, and which was paid under protest by the respondents as her executors.

Statement.

The respondents accept in the main the statement of the case in the Government's brief as far as it goes, but that statement falls short of a fair and full presentment of the facts.

The respondents do not accept the Government's statement of the question involved.

Under a Tax Statute the broad policy of which throughout is to favor and exempt charities in every possible way, the Government in the present case is seeking by a strained and artificial construction and application violating both the letter and the spirit of the Act to cast an additional tax burden of over $400,000. on the charitable legatees under Mrs. Sage's Will.

The question at issue, therefore, is the proper method and procedure to be followed in computing the Federal Estate Tax under the provisions of the Revenue Act of 1916 as amended by the Revenue Act of 1918, when charitable legacies (which under the Statute are not taxable) constitute the entire residuary estate of the decedent.

The Executors made a return in the usual manner and form *without considering the tax itself in any way,* which return may be summarized as follows:

Value of the gross estate		$49,129,256.99
Funeral and administration expenses and debts	$3,781,321.74	
Amount of general bequests to charitable, religious, educational and similar purposes	1,285,000.00	
Amount of residuary bequests to charitable, religious, educational and similar purposes	35,436,855.70	
Specific exemption	50,000.00	40,561,177.44
NET ESTATE		$8,568,079.55
TAX		1,406,977.50

The net estate of $8,568,079.55 ascertained and returned as above must be and is in fact the exact amount of all bequests and devises to other than charitable legatees, less the specific statutory exemption of $50,000, and the Executors insist that this is the only amount and the whole amount that is taxable under the letter and the spirit of the Act.

The Government disputes only the one item of the amount of the charitable residuary bequests, claiming that the Federal Estate Tax itself should be considered and determined and deducted from the charitable residue *before* ascertaining, and for the purpose of ascertaining the net estate. By thus decreasing the deduction for the charitable residuary bequests the net estate is increased over the total aggregate amount of all bequests and devises to non-charitable legatees by the exact amount of the Estate Tax, and the tax is increased by the amount of the tax computed on the tax.

The Government contends that since under the law of New York the burden of the Federal Estate Tax falls upon the residuary estate the charitable residuary legatees will not actually receive the whole residue, but only so much as is left after the Estate Tax is taken out of it, and therefore that the Estate Tax should be computed and paid not only on so much of the estate as passes to non-charitable legatees but also upon the Estate Tax thereon which is taken out of the residue and paid to the Government, and again on the additional Estate Tax thus computed and so on progressively, the Estate Tax continually increasing as in the computation in each case it is imposed upon itself, with the result that there is a series prolonged to infinity.

It is obvious that it is impossible under the Government's theory to compute the tax by arithmetic, and for the purpose of determining the result of this infinite series of taxes on taxes, the mathematical experts of the Treasury Department worked out an algebraic formula to be used for the purpose of computing the tax when the residuary estate is left in whole or in part to charitable legatees. That formula and its application to the decedent's estate are set forth at length in the Amended Bill of Complaint (Record, pp. 6, 7) the formula being as follows:

EXPLANATION OF TERMS USED.

G = Gross estate
N = Net estate
R = Residue
T = Federal Estate Tax
D = Known deductions } When taken together
E = Specific deductions } known as A
S = Property specifically disposed of (this includes specific bequests, transfers, debts, funeral and administration expenses and State Inheritance Taxes)

K = Total tax on all blocks up to the last one used
B = Total of blocks the tax on which is represented by K
% = Rate of tax on the last block

FORMULA

$$G = R + S + T$$
(1) $$R = G - S - T$$
$$T = K + \% (N - B)$$
$$T = K + \% N - \% B$$
$$T = K + \% [G - (A + R)] - \% B$$
$$T = K + \% G - \% (A + R) - \% B$$
$$T = K + \% G - \% A - \% R - \% B$$

Substituting in (1)

$$R = G - S - (K + \% G - \% A - \% R - \% B)$$
$$R = G - S - K - \% G + \% A + \% R + \% B$$
$$R - \% R = G - S - K - \% G + \% A + \% B$$

Counsel for the Government in their brief in this Court discreetly refrain from any reference to this formula. In the Court below, however, they sought to justify it and to explain it and insisted that it was quite simple; but the respondents respectfully submit that it is a triumph of higher mathematics quite beyond the comprehension of the ordinary citizen.

The question involved in the case at Bar may therefore be completely and concretely stated as follows:

> Does the proper method and procedure for the computation of the Federal Estate Tax under the Revenue Act of 1916 as amended by the Revenue Act of 1918, where the residuary estate is left to charity, require that the amount of the Estate Tax should be considered and determined by means of an algebraic formula before the ascertainment of the net estate and added to the net estate for the purpose of the computation of the tax and the Estate Tax thus increased by the amount of the tax on the tax?

ARGUMENT.

I.

The Formula.

The purpose and the result of the use of the formula in the present case is the addition to the net estate of the sum of $1,820,607.12 which is the amount of the tax computed on the actual net estate plus that same amount, thus creating a purely fictitious and artificial basis for the computation of the tax; it is not the actual net estate—it is not the amount which passes to the non-exempt legatees or to anybody. It is simply an arbitrary figure which represents the taxable estate plus $1,820,607.12 and the resultant tax claimed is a tax on the net estate plus a tax on the added sum of $1,820,607.12 which has no existence as any part of the decedent's estate.

By the use of that formula the Government before ascertaining, and in fact without ever ascertaining the net estate as required by the Statute, determines the amount of the Estate Tax by including the amount of the tax on the tax in a series prolonged to infinity. But the respondents contend that any construction of the taxing statute which requires in its application and in the computation of the tax the use of that formula must be wrong. No such construction and no such method of computing the tax could possibly have been within the legislative intent. It is inconceivable that Congress when it directed by the Statute that an executor should file a return under oath setting forth the value of the net estate ascertained as therein prescribed and the tax payable thereon, intended to impose a tax which, in the very ordinary and frequent case where the residuary estate

is left in whole or in part to charity, could be computed only by an expert skilled in higher mathematics.

Referring to this feature of the case Judge Hough says, in his opinion in the Circuit Court of Appeals (Record, p. 34):

> "We need not go so far, but do hold that the presumption is that Congress intended a simpler method —one that a plain man can understand. Algebraic formulæ are not lightly to be imputed to legislators."

In the enactment of the present Revenue Laws a change was made from the Legacy Tax of previous Federal Inheritance Tax Laws to an Estate Tax for the express purpose of substituting a tax which would be simpler and easier of application and computation. Mr. Kitchin, the Chairman of the Ways and Means Committee, in explaining to the House the nature and purpose of the Estate Tax Law, said:

> "We levy the tax on the transfer of the flat or whole net estate. We do not follow the beneficiaries and see how much this one gets and that one gets, and what rate should be levied on lineal and what on collateral relations, but we simply levy on the net estate. This also prevents the Federal Government through the Treasury Department going into the Courts and contesting and construing wills and statutes of distribution".
>
> (See Matter of Hamlin, 226 N. Y. 407 at p. 415.)

As an incidental step in the computation of the tax it is necessary to determine the amount of the charitable residuary legacies, which amount under the Statute is deductible from the gross estate to ascertain the net estate, *but such determination of the charitable residue is solely for the purposes of the taxing statute.* The Government is not concerned with what any legatee,

charitable or otherwise, will ultimately receive and the question of the amount of the residue whether charitable or otherwise, for the purposes of the taxing statute is controlled by the settled principle and rule universally accepted and adopted in the construction and application of a taxing statute and the computation of a tax, namely, that a tax must always be levied and computed without regard to its own incidence.

Mrs. Sage by her Will gave general and specific legacies and devises to individuals aggregating $8,618,-079.55, and also general legacies to charities aggregating $1,285,000. The whole of her large residuary estate was left to charity.

Her Executors adopted the simple, direct and obvious method of ascertaining the net estate and computing the tax which would naturally be followed by the ordinary intelligent person. They deducted from the gross estate the debts and administration expenses and the general and specific legacies and devises to find the amount of the residuary estate, all of which was left to charity. Then in order to ascertain the *net estate* under the statute, they deducted from the gross estate the debts and administration expenses; the general charitable legacies; the charitable residuary estate and the specific exemption of $50,000, and the net estate thus determined was necessarily the exact amount of all legacies and devises other than charitable, less the specific exemption of $50,000.

It would seem clear that under the facts in the present case the *net estate* the transfer of which was properly subject to Federal Estate Tax under the letter and the spirit of the Act would be only the exact amount of all legacies and devises other than charitable, less the specific exemption of $50,000.

Judge Rose, of the District of Maryland, in the recent case of Dugan *vs.* Miles, 276 Fed. Rep. 401, in which the amount of the Federal Estate Tax was involved (though not the precise question presented in the case at bar), *took exactly this view of the matter.*

In the opening paragraph of his opinion he uses the following language:

276 Fed. Rep. 402:

> "The late Thomas O'Neill bequeathed some taxable legacies to persons other than his widow, but as there is no dispute about the tax on them they may be ignored in this discussion. All the rest of his large property was left to trustees, during the life of his widow. They were to accumulate the income thereon, were to pay to her an annuity of $25,000. during her life, and at her death, after applying $250,000. to such uses as she might by will appoint, they were to turn all the rest of the estate over to three corporations, legacies and devises to every one of which were exempt from the estate tax. *All therefore that can be taxable is what the widow is either to receive or to dispose of.*"

And again on page 402:

> "It is clear that this sum largely exceeds the present value of everything which will in any sense ever go to the widow, and that therefore something has been taxed which Congress intended to exempt."

Having computed the exact present worth of all that the widow was ever to receive or dispose of, Judge Rose then said (p. 403):

> "And that is all that should be taxable if full effect is to be given to the will of Congress."

On appeal one part of the decision was reversed but on this point the Circuit Court of Appeals (Fourth Circuit) followed Judge Rose (292 Fed. 131).

This is a short and simple way of ascertaining the exact amount of the estate the transfer of which is properly subject to the Federal Estate Tax, but the same result is reached by preparing a return in the usual way, following the express provisions of the Statute and adopting the method which was followed by Mrs. Sage's executors and which would seem to any one to conform to the evident and clear meaning of the law.

Judge Hough in his opinion, referring to the case of Dugan *vs.* Miles, says (Record, p. 35):

> "So far as the authority goes, Dugan *v.* Miles, 276 Fed. 401, is the only decision suggested on this branch of the statute. The facts in that litigation were legally identical with those at bar; yet it is true that the doctrine here contended for by the Treasury was not alluded to by the experienced and able judge who wrote the opinion, although his result is consistent only with the methods pursued by these defendants in error. The inference is that neither the judge nor counsel on either side thought of such a theory—which does not seem to us surprising."

II.

It is an elementary and fundamental principle of taxation that a tax is imposed and assessed wholly without regard to the incidence of the tax itself.

This proposition or rule of law requires no citation of authorities. It is universally accepted and applied and has been accepted and adopted by the District Court and by the Circuit Court of Appeals as controlling in the case at Bar.

As Judge Hough, writing for the Circuit Court of Appeals, says (Record, p. 35):

> "As Holmes, *J.*, remarked in the New York Trust Co. case (*Supra*), 'Upon this point a page of history is worth a volume of logic'. History so far as we can discover, shows no other instance of attempting to measure a tax *pro tanto* by itself. As Hand, *J.*, said in the Court below, this theory departs from long established practice and from the usage if not the law of never regarding the incidence of the tax in the levying of a tax."

In every State legacy or succession taxes whether imposed on the right to transmit or the right to receive, or whether imposed on the estate as a whole or on the interests of the beneficiaries are levied and computed wholly without regard to the incidence of the tax itself.

The amount of the residuary estate is determined under the law of the State of New York without deducting the New York Transfer Tax or any Estate or Inheritance Taxes, whether Federal or State, *and the amount of the charitable residuary bequests under Mrs. Sage's Will has been so determined.*

See

Matter of Swift, 137 N. Y. 77;
Matter of Penfold, 216 N. Y. 163; also 216 N. Y. 171;
Matter of Sherman, 179 App. Div. 495; affd. 222 N. Y. 540.

We submit that this rule must be consistently followed in every case for every purpose and in every step in the computation of the Federal Estate Tax; that the amount of the net estate must accordingly be ascertained without considering the Estate Tax itself in any way and if in the process of ascertaining the net estate it becomes

necessary to determine the amount of the residue the same rule must be followed and that also must be determined without considering the tax in any way.

The Government adopts and follows this rule and wholly disregards the tax in the ascertainment of the net estate and the computation of the tax, in every case except where the residuary estate is left in whole or in part to charity, and in such case alone it wholly disregards the rule and by means of a complicated algebraic formula determines the tax before ascertaining the amount of the net estate upon which under the Statute the tax must be computed, the tax thus pre-determined being based upon an artificial and fictitious net estate which is composed of the actual net estate plus the amount of the tax itself.

The whole Act looks to the property of the decedent when he dies and which is transferred from him to his beneficiaries before payment of the tax, and wholly disregards the property which the beneficiary will ultimately receive after the payment of the tax. The tax is measured by the net amount of the estate transferred regardless of the tax itself. The amount of the tax is not considered in determining the value of the gross estate or of the net estate. For all purposes of the application of the Act and the computation of the tax the Government recognizes the theory and principle that the tax is based upon that which is transferred from the decedent regardless of the tax itself, except only in connection with the Exemption Clause providing for the deduction of the amount of charitable bequests where it adopts the directly opposite theory of regarding not what is transferred subject to the payment of the tax, but what the beneficiary may receive after the tax has been paid out of the prop-

erty transferred. In other words, the Government blows hot and cold at the same time, adopting one theory for the purpose of ascertaining a residue subject to tax, and a directly opposite theory for the purpose of ascertaining a residue exempt from tax.

Where the Government undertakes to determine the amount of the estate in order to tax it, it insists that the amount of the tax to be imposed should not be considered. The taxing authority closes its eyes to that which is taken out of the estate by way of taxes, and values the estate as though it itself took nothing from it.

Consistently the same rule must be adopted and followed in computing the amount or value of an estate for the purpose of exempting it as when computing the amount or value of an estate for the purpose of taxing it.

If a tax were being imposed upon the residuary estate, its amount would be determined without deducting from it the tax itself. Obviously, when the amount of the residuary estate is to be determined, not for the purpose of taxing it but for the purpose of exempting it, the same rule must be applied. The expression "amount of the legacy" must have the same meaning, whether it be used to state the amount to be taxed or the amount not to be taxed.

The Government strenuously asserts that, in determining the amount to be taxed, we must entirely disregard the incidence of the tax, *i. e.*, that we must ignore the fact that the amount received by the legatees will be reduced by the amount of the tax; but it now asserts that, in determining the amount not to be taxed, the incidence of the tax should be regarded, *i. e.* that we should take into account the fact that the amount to be received will be

reduced by the amount of the tax. There is obviously no basis in logic or in reason for the distinction. The Government's claim in this case so clearly violates fundamental principle, and is so unfair that the lower courts unanimously and promptly overruled it.

Any tax is ordinarily paid out of the property upon which it is imposed, or in other words the property taxed includes the amount of the tax which is afterwards paid out of that property. But that is the logical result of the universal rule that a tax is always imposed without regard to its own incidence and is a very different matter from *adding* the amount of the tax itself to the value of the property subject to tax, thus creating a purely artificial basis for the imposition of the tax and resulting in an increased tax not computed upon the actual value of the property taxed and including the amount of the tax, but upon that value plus the tax. Such a method and procedure for the computation and imposition of a tax is utterly indefensible and we venture to say was never before proposed or attempted by any taxing authorities.

III.

For all purposes of an Estate Tax or an Inheritance Tax the residue of an estate is that which is left before the tax is taken out.

The entire argument of the Government is presented under the heading of a single proposition of law, namely, that the residuary estate is that which remains after all paramount claims upon the estate have been satisfied.

For the purposes of a judicial accounting and from the standpoint of the residuary legatees that statement

may be true; but it is not true from the standpoint of a Tax Statute or for the purposes of the computation of an Estate Tax or an Inheritance Tax.

The Government has admitted that the State Estate Taxes which are also paramount charges on the whole estate and have in fact been paid out of the charitable residue should not be deducted in determining the amount of the charitable residue to be deducted for the purposes of the Federal Estate Tax and has consented to the entry of judgment in this action in favor of the Executors in the sum of $112,172.17 with interest, representing the tax on the aggregate amount paid by the Executors for State Estate and Inheritance Taxes and which the Government had previously treated in the same manner as the Federal Estate Tax and had deducted from the residue left to charity before in turn deducting that residue from the gross estate.

Under the law of New York the value of an estate for the purpose of computing the State Transfer Tax is determined without deducting any Estate or Inheritance Taxes, either Federal or State, and the New York rule is followed in the States of Wisconsin and Rhode Island.

The Government cites a number of cases in other States holding in substance that the Federal Estate Tax is in the same catagory with debts and administration expenses and must therefore be deducted before assessing the State Estate or Inheritance Taxes; but in those same States the value of an estate, and of any legacy, residuary or otherwise, for the purpose of the computation of their own State Estate or Inheritance Taxes is determined without considering and without deducting such State Estate or Inheritance Taxes.

The argument of the Government and the logic and reasoning of every one of the cases cited upon this point lead inevitably to the conclusion that the Federal Estate Tax must in every case be deducted from the gross estate in order to determine the net estate under the express provisions of the Revenue Act of 1916.

In the Massachusetts case quoted on page 11 of the Government's brief the State Court says (238 Mass. 549):

> "The estate upon the death is to the extent of the tax instantly depleted."

The New Jersey Court says in the case cited on page 12 (89 N. J. Eq. 168):

> "The clear market value of the property transferred from the dead to the living is the value of the estate after all lawful charges against it, including taxes, are satisfied."

In the Oregon case the Court said, as quoted on pages 13 and 14 of the Government's brief (101 Ore. 182):

> "No part of the Federal Estate Tax * * * ever passed, theoretically or actually, to the widow or daughter; for this tax was imposed and collected before its distribution and like the old probate tax ought to be deducted from the gross estate just as expenses of administration are deducted."

The Revenue Act of 1916 provides that the value of the net estate shall be determined by deducting, among other things,—

> "such other charges against the estate as are allowed by the jurisdiction, whether within or without the United States, under which the estate is to be administered."

The position of the Government is therefore in every aspect illogical, inconsistent and unsound. If the Federal

Estate Tax is a paramount charge against the whole estate allowed by the jurisdiction of the State under which it is administered and in the same category with debts and administration expenses, it is under the express words of the Act deductable in every case from the gross estate in order to ascertain the net estate. In other words, if for the purposes of the taxing statute the residuary estate is only that which is left after the tax is paid, then the tax is deductable from the gross estate in every case, but if the Act is to be construed and applied without regard to its own incidence then the residuary estate must for the purposes of the Act he deemed to be that which is left *before the tax is paid.*

The supposititious case stated on page 10 of the Government's brief, namely, where a residue left to charity without diminution by the amount of the Federal Estate Tax is less than the bequest, *does not* show the fallacy of the respondents' contention, but on the contrary demonstrated the injustive and unsoundness of the Government's argument. In such a case it is true the charitable residuary legatees would receive nothing and there would be a necessary abatement of the general legacies to pay the tax. But the residuary estate determined without considering the tax and which was left to charity by the Will, should nevertheless be deducted, because no penny of it is left to any non-charitable legatee and no penny of it would pass to any non-charitable legatee and therefore no part of it should be taxed under the Revenue Act of 1916. It would be manifestly unfair, unjust and not contemplated by the Statute that the estate tax should be imposed and computed on an amount in excess of all the bequests to non-charitable legatees and that general legacies already subject to abatement to pay the estate tax should suffer a further abatement to pay an additional

tax computed on an amount taken out of the estate by the Government and which was not in form or in fact left to any non-charitable legatee and no penny of which in any event could pass to a non-charitable legatee, and no penny of which could form part of the net estate.

The other supposititious case stated in the Government's brief on pages 16 and 17 does simplify the problem and strengthens the contention, not, however, of the Government, but of the respondents. If Congress could have passed a law providing that the amount of all bequests to charity should be taxed at a higher rate than other bequests, all such charitable bequests, whether general or residuary (and there could be no reason for making any distinction between them) under well settled principles of law would be taxable at such increased rate at their full face amount without considering the tax and without making any deduction for the tax in any case.

IV.

The Government's method of computing the tax results in the imposition of a further and very heavy tax burden upon charitable residuary legatees in violation of the clear intent and policy of the act of favoring charities in every way and exempting them from any and every form of tax imposed thereby.

The Estate Tax is not contained in a separate or special act of Congress, but is a part of the General Revenue Acts of 1916 and 1918, and therefore all parts of those Acts must be read together to ascertain their true intent and meaning. The broad policy clearly appears throughout the recent Revenue legislation of Congress,

not only of relieving and exempting charities in a broad sense from any and every form of tax imposed by the said Acts, but further of fostering and favoring charities by provisions indirectly operating to their advantage, as in the case of the taxes on admissions and dues. This policy is even carried to the point of exempting from the Income Tax up to 15% of the income of any individual given by him to charity. The Estate Tax being in form assessed upon the decedent's estate and not upon the separate interests of the beneficiaries, the exemption of charitable bequests and devises is accomplished by providing that the amount of all such bequests must be deducted from the gross estate for the purpose of ascertaining the net estate subject to taxation.

That part of the Revenue Act of 1918, the clear purpose and intent of which is to favor charities and to exempt them from the Estate Tax and which may properly be called the Exemption Clause of the Estate Tax Title should therefore be broadly construed and applied in order to give the fullest possible effect to that intent and thus bring the construction and application of the Estate Tax Title into harmony with the broad policy, clearly appearing throughout the Act, of favoring charities in every possible way.

The Federal Courts have directly held that provisions in favor of charities should be broadly construed in conformity with the spirit of the Act, and that the substance and spirit and not mere form and words should control.

Thus in Lederer *vs.* Stockton (266 Fed. Rep. 276, affirmed 260 U. S. 4), the Circuit Court of Appeals, in construing the provisions of the Income Tax Law exempting from the Income Tax income passing to charities, said:

> "It is clear that when substance and spirit and not mere form and words are the interpreters of

> the Statute, the receipt of this income by the Hospital's agent and representative was in truth and reality a receiving by the Hospital."

The estate of the decedent transferred under her Will falls naturally into two parts, one part legacies to individuals and the other part legacies to charities. The first part is taxable. The second part is not taxable. In view of the clear intention to favor charities in every possible way it probably was not within the contemplation or intention of Congress that the Estate Tax on taxable legacies should be actually charged against and paid out of non-taxable legacies. But that result unavoidably follows in a New York estate under the decision in the Court of Appeals in the Hamlin case (226 N. Y. 407) holding that the Federal Estate Tax is a charge against the whole estate and payable by the Executors as an expense of administration.

It certainly was not the intention of Congress that the Estate Tax itself should be added to the taxable legacies for the purpose of assessing thereon an additional Estate Tax to be charged against and paid out of the charitable legacies which it intended to exempt wholly from taxation.

Judge Hough says in his opinion (p. 35):

> "Again, observing the language of the statute, it may be admitted that net estate is used but as a measure for tax, and is not itself taxed, for the impost is said to fall upon the entire property. This is a mere matter of words; for practical purposes the net estate is the taxable estate.
>
> It is therefore a fundamental injection, not only as to the spirit but as to the letter of this act, that the taxable estate is augmented by a deliberate and designed encroachment upon charities.

> It is the intent of the statute that charitable bequests shall not be taxed. By its regulation of the incidence of the tax, New York does in fact diminish in favor of the United States what the charities receives; but it must be wrong for the executive departments of the United States to use the rule of incidence, which is of State creation, to increase its own exactions."

If Mrs. Sage had left $35,000,000 in general legacies to charitable legatees and a residuary estate of $8,000,000 to non-charitable legatees, the $35,000,000 of general legacies would have been deducted without question and the tax computed upon the $8,000,000 residue and paid out of that residue, thus falling upon the beneficiaries who should properly bear the burden of the tax; but because Mrs. Sage left $8,000,000 in general legacies to non-charitable legatees and left a residuary estate of $35,000,000 to charitable legatees the Government insists that the tax the burden of which under the law of the State of New York falls not upon the taxable legatees but upon the exempt charities, should be increased by over $400,000, that amount representing the tax computed upon the amount of the tax itself. The Government argues that this unfortunate result arising from the method and manner in which it claims the tax must be computed is something for which the testatrix and not the law is responsible, a contention which is answered by Judge Hough in his opinion as follows (p. 34 of the Record):

> "It is next observable that this using of tax to measure tax will only happen when the residuary estate or some part of it is devoted to charity or other deductible purpose. If this testatrix had made her charitable bequests before inserting a residuary clause no difficulty would have arisen. It is argued with apparent seriousness that this is 'something for which the testatrix is responsible', which is true only

> if the law laid such a trap as this for charitable residuary legatees as distinguished from equally charitable general legatees—again something not lightly imputable to the lawgiver."

The words of Mr. Justice White in the famous case of Knowlton *vs.* Moore, 178 U. S. 41, directly apply to the case at bar.

The Statute then before the Court was the Federal Inheritance Tax of 1898. He pointed out that the confusion which gave rise to the various constructions of the Statute which were urged upon the Court resulted (178 U. S. 77)—

> "from not keeping in mind the distinction between the tax on the interest to which some person succeeds on a death and a tax on the interest which ceased by reason of the death; the two being different objects of taxation."

Then having decided the nature and theory of the tax imposed by the law then before the Court, he construed and interpreted all of its provisions in harmony with that single theory, and in announcing a simple, workable, just construction he said (178 U. S. p. 77):

> "We are therefore bound to give heed to the rule that where a particular construction of a statute will cause great inconvenience or produce inequality and injustice, that view is to be avoided if another and more reasonable interpretation is present in the statute."

It is confidently submitted that in the case at Bar the complicated theory and method adopted by the Government in the computation of the Estate Tax with their inherent inconsistency and violation of the general nature and theory of the tax, and resulting in the imposition of a heavy tax burden upon charity in utter

disregard and violation of the broad policy of the Statute must be discarded and repudiated in favor of the simple, reasonable and consistent theory and method adopted by the Executors in this case.

V.

The Federal Estate Tax is imposed upon the *transfer* of the decedent's property which is permitted, regulated and effected under the laws of the State of the decedent's domicile, the tax being measured by the value of the *net estate which is transferred* under the State law.

The transfer or devolution of the property of a decedent whether by will or intestacy is entirely within the jurisdiction of the various States.

In the leading case of Knowlton *vs.* Moore, 178 U. S. 41, at page 58, this Court has held:

> "Of course in considering the power of Congress to impose death duties we eliminate all thought of the greater privilege to do so than exists as to any other form of taxation as the right to regulate successions is vested in the States and not in Congress."

In the case of Wardell *vs.* Blum, in the Circuit Court of Appeals for the Ninth District, reported in 276 Fed. Rep. 226, affirmed 258 U. S. 617, the question there being the inclusion in the gross estate of a decedent for the purpose of the Estate Tax under the Revenue Act of 1916 of

the widow's interest in community property, the Court held:

> "(2) The Statute of the United States imposes an inheritance tax upon the transfer of the net estate of every decedent 'to the extent of the interest therein of the decedent at the time of his death which after his death is subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate'. Sections 201-203, 39 Stat. 777.
>
> How is that interest to be determined?
>
> (3) Manifestly, we think, by the law of the State where the property is situated."

Under the law of New York the property which was transferred and passed under this decedent's Will to the charitable residuary legatees was the entire residue before deducting therefrom any Estate or Inheritance Taxes, whether Federal or State.

See Matter of Swift, 137 N. Y. 77, quoted above.

In the Matter of Hamlin, 185 App. Div. 153; affd. 226 N. Y. 407, Judge Kruse, writing the opinion in the Appellate Division, at page 155 says:

> "It (the Federal Estate Tax under the Act of 1916) is not a tax upon the property but upon the transfer thereof. The net value measures the tax. *The title passes from the decedent charged with the tax.*"

See also

> Matter of Ramsdill, 190 N. Y. 492;
> People *ex rel.* Andrews *vs.* Cameron, 140 App. Div. 76; affd. 200 N. Y. 584;
> People *ex rel.* Crook *vs.* Wells, 179 N. Y. 257.

Under the above decisions of the Court of Appeals it is the settled law of New York that the property of a

decedent which is transferred and passes to the residuary legatees is the full amount of the residue determined in the usual way recognized and followed by the State Courts by deducting from the gross estate the general and specific legacies and the debts and expenses of administration but wholly disregarding any Federal or State estate or inheritance taxes. The full amount of the residue thus ascertained is *the amount of the residuary bequest* which is transferred and passes under the Will. If the transferees are charities that full amount is the amount which must be deducted from the gross estate under the Exemption Clause of the Revenue Act of 1918.

VI.

If the property out of which the Federal Estate Tax was paid *was not transferred under the decedent's Will* it was not part of the net estate.

If the property out of which the Federal Estate Tax was paid *was transferred under the decedent's Will* it was necessarily part of the property which passed to the legatees charged with the payment of the tax, and in the present case was included in the amount of the charitable residuary bequests and was therefore deductible from the gross estate.

The nature of the Federal Estate Tax is settled beyond any question of doubt.

It is a privilege tax on *the transfer of the net estate* of a decedent and it is measured by the value of *the net estate transferred.*

In the present case the only property the value of which forms part of the gross estate or of the net estate for the purposes of the computation of the tax is that described in subdivision (*a*) of Section 202 as follows:

> "Sec. 202. That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property real or personal, tangible or intangible, wherever situated.
>
> (*a*) To the extent of the interest therein of the decedent at the time of his death which after his death is subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate."
>
> (The other elements mentioned in subsequent clauses entering into the net estate as a measure of the tax are not material here.)

It is submitted that nowhere in the Revenue Act of 1916 can there be found any intimation of an intention on the part of Congress to impose the Estate Tax on the amount of the Estate Tax as such.

In the case of Gould *vs.* Gould, reported in 245 U. S. 151, the Court declared the general rule to be applied in the interpretation of the Revenue Act as follows:

> "In the interpretation of the statutes levying taxes it is the established rule not to extend their provisions by implication beyond the clear import of the language used, or to enlarge their operation so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government and in favor of the citizen."

Both the gross estate and the net estate must be constituted and build up only of property falling squarely within the words of the taxing statute, and no property can possibly form part of the net estate unless in the first instance it forms part of the gross estate.

Thus in the case of United States *vs.* Field, 255 U. S. 257, the Supreme Court held that property passing under a general power of appointment could not be included in the net estate of the donee of the power for the purposes of the Estate Tax because such property was not clearly and certainly covered by the words of the taxing act (Revenue Act of 1916).

The amount of the Federal Estate Tax as such certainly was not *transferred under the decedent's Will* to the United States Government.

If therefore the property actually used to pay the Federal Estate Tax was taken and appropriated by the Government at the instant of death and if it was not transferred and could not be transferred under decedent's will, as contended by the Government, it clearly was not part of the gross estate or of the net estate the transfer of which is taxed by the Act.

If on the other hand, as contended by the Executors, the property used to pay the Estate Tax was a part of the gross estate and was transferred under the decedent's will it must necessarily, have been a part of the residuary estate which passed in the first instance to the residuary legatees, charged however with the payment of the tax.

The property actually used to pay the Tax either was transferred or it was *not transferred.*

If it was not transferred it was not part of the gross estate nor of the net estate and therefore neither taxable nor the measure *pro tanto* of the tax.

If it was transferred it must have passed as part of the residuary estate to the charitable residuary legatees and therefore was not part of the net estate and neither taxable nor the measure *pro tanto* of the tax.

VII.

The Government by confessing error to the extent of the State Estate and Inheritance Taxes which were at first claimed to be deductible from the charitable residue, has in fact conceded its whole case.

The Executors here contend for the broad proposition that the Federal Estate Tax must be computed and assessed wholly without regard to the incidence of the tax itself or of any estate or inheritance taxes.

If however, as claimed by the Government, under the Estate Tax Title of the Revenue Act of 1916 no logical distinction can be drawn between a State Estate Tax and the Federal Estate Tax and both are paramount charges against the whole estate and ultimately payable out of the residue, then both are deductible from the gross estate.

The Government has conceded that the amount taken out of the charitable residue to pay State Estate Taxes should not be considered in determining the charitable residue to be deducted for purposes of the Federal Estate Tax, and yet the charities do not actually receive the moneys used to pay the State Estate Taxes any more than the moneys used to pay the Federal Estate Tax.

We submit that under the literal construction and meaning of the provisions of the Estate Tax Title of the Revenue Act of 1916, both State Estate Taxes and also the Federal Estate Tax itself are in every case allowable deductions from the gross estate. Such, however, was probably not the intention of Congress because it would

violate the fundamental rule of taxation for which the executors here contend, namely, that a tax is always computed and assessed without regard to the tax itself, but if that rule is to apply in one case, overriding the strict and literal construction of the express words of the statute, it must necessarily apply consistently in every case.

It might be a not unreasonable construction of the statute that it was intended to impose its own tax without regard to the incidence of that tax but having regard to the incidence of State Taxes, but the contention of the Government in this case, namely, that the Federal Estate Tax shall be computed and ascertained *with regard* to the incidence of that tax, but *without regard* to the incidence of State Estate Taxes is a legal absurdity.

VIII.

The judgment should be affirmed, with costs.

Respectfully submitted,

DeForest Brothers,
Attorneys for Respondents.

Robert Thorne,
of Counsel.